Market View
Economics and Strategy

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Some tariff clouds are parting but there’s no sun in the forecast

By Taylor Schleich & Ethan Currie

A few months ago, Canadian “soft data” was in crisis territory. Consumers and businesses had *never* been more downbeat, as the early days of the Trump administration were characterized by disproportionate threats to Canadian exporters. A lot has changed since then. Canada subsequently moved out of the President’s crosshairs as he shifted his focus to rest of the world on Liberation Day. Moreover, the impact of tariffs on Canadian businesses has been less pronounced than feared given exemptions for USMCA-compliant goods. As a result, most measures of confidence have improved. Make no mistake, though: An improvement does not equate to a strong outlook. Indeed, the BoC’s latest *Business Outlook Survey* (BOS), conducted between May 8th and May 28th, reflects a still unsettled backdrop that will weigh on the economy this year:

- Overall, firm sentiment softened slightly, the headline BOS indicator edging down to -2.4 from -2.1. The BoC notes that “worst-case scenarios” are now seen as less likely and that more timely monthly survey results suggest confidence has improved recently. Still, there are 28% of firms planning for a recession (vs. 15% in Q4 last year).
- There is “broad-based” weakness in future sales indicators. That’s a function of a cautious consumer, weak housing markets and lower oil prices. Among exporters, tariff anxiety is reduced but the sales outlook is soft given the earlier front-loading from U.S. companies.
- Investment and hiring intentions remain historically low as most businesses plan to keep staffing levels steady and only undertake necessary capital spending (i.e., maintenance).
- The prevalence of labour shortages and capacity pressures increased slightly but remain well below historical averages.

Released at the same time as the BOS, the *Canadian Survey of Consumer Expectations* (CSCE) also paints a downbeat picture:

- The new CSCE indicator suggests sentiment slid in Q2, driven by a deteriorating financial health and spending outlook. Job security concerns have moderated but Canadians are still uneasy and continue to view the labour market as being soft.

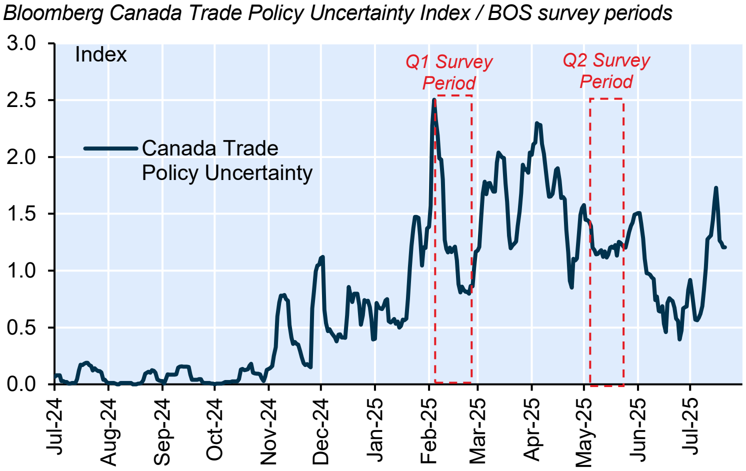
This degree of caution from businesses and consumers might normally be met by monetary policy support. However, stubbornly warm core inflation and anxiety around tariff-led price increases have left the Bank of Canada immobile, for now. The good news is that inflation *expectations*, identified by the BoC as an indicator to guide monetary policy, are perhaps less worrisome than before:

- While input price growth is expected to accelerate, that trend may not extend to selling price growth based on the BOS. The most common response to rising costs? Margin compression.
- Overall, longer-run measures of inflation expectations were little changed relative to last quarter. But there has been a sharp decline in *near-term* inflation expectations, which is where the pick-up was most pronounced in Q1. Meantime, consumer inflation expectations remain a bit high but didn’t accelerate vs. 3 months ago.
- Tariffs may still present some inflation risks, but the same can’t be said for wages. Expected wage growth continued its steady moderation and is now back to pre-pandemic levels.

When it comes to next week’s BoC meeting, the decision has arguably already been made. We see the central bank holding steady in light of aforementioned core inflation pressures (and risks). June’s reported labour market “strength” also doesn’t scream for immediate rate relief. Saying that, we’re not embracing the growing view that this easing cycle is over and overall, this BOS supports that. These data suggest that the economy will continue to operate below its potential (at least over coming months) and leaves us even more skeptical of June’s hiring surge. Ultimately, inflation will be in the driver’s seat but continued and/or growing economic slack is not consistent with persistently above target inflation, even with some tariff effects. Despite OIS market skepticism, the Bank could be off the sidelines sooner than expected.

Chart 1: Q2 BOS captures lower yet still elevated uncertainty

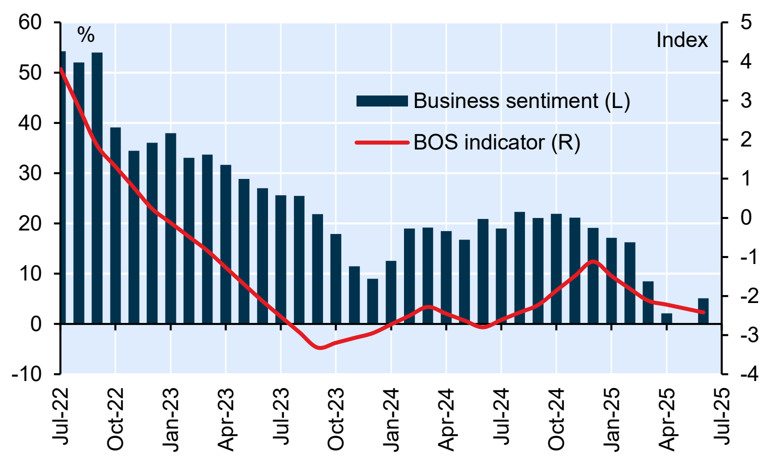
Bloomberg Canada Trade Policy Uncertainty Index / BOS survey periods



Source: NBC, Bloomberg, BoC

Chart 2: Sentiment remains subdued, as BOS indicator slides

BOS Indicator & Business Leaders’ Pulse Sentiment Index

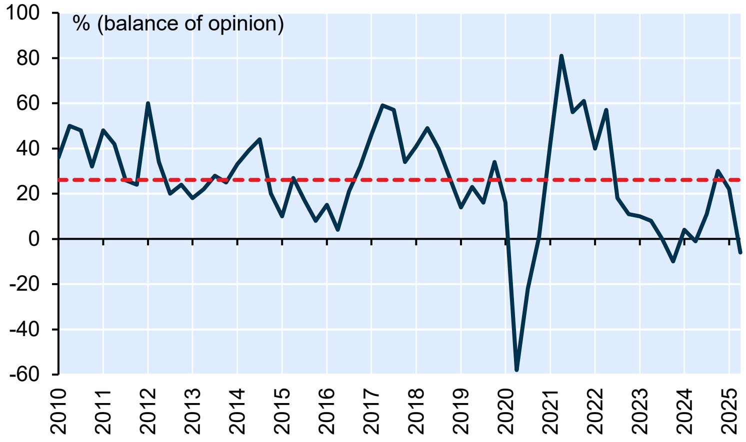


Source: NBC, BoC | Note: BOS indicator is quarterly, interpolated to generate monthly series

Business sentiment softened further in Q2, despite the survey being conducted *after* peak trade uncertainty. This suggests a weak Canadian outlook is not *just* a tariff story. While timelier measures of sentiment (via the Business Leaders’ Pulse) improved in June, this is hardly a buoyant outlook. Moreover, trade tensions have since intensified, bringing into question the durability of the rebound.

Chart 3: Future sales indicators fall sharply…

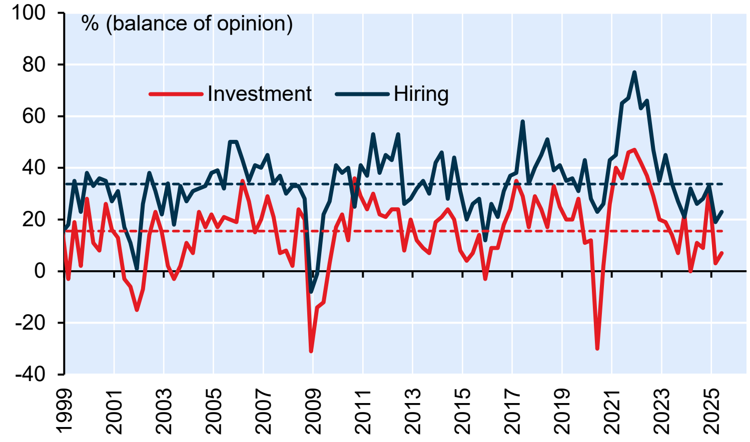
Indicators of future sales, with historical average



Source: NBC, BoC | Note: Dotted line reflects average since 2010

Chart 4: …leading to muted investment, hiring plans

Employment and investment intentions, balance of opinion & historical averages

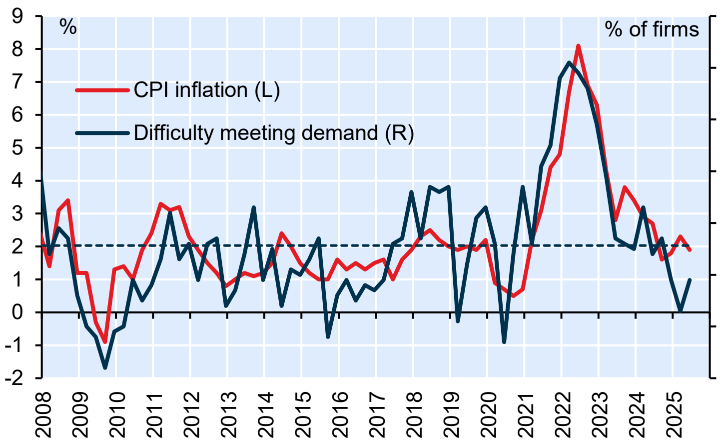


Source: NBC, BoC | Note: Dotted lines denote survey average, since Q3:1998

Indicators of future sales fell sharply in Q2 and are well below historical norms. It's not surprising then that businesses are remaining cautious when it comes to investing and hiring. This doesn't imply a particularly robust growth outlook for Canada. It also leads us to further doubt the reported surge in hiring in June. To us, H2 will be characterized by growing labour market slack.

Chart 5: Lack of capacity pressure should limit inflation

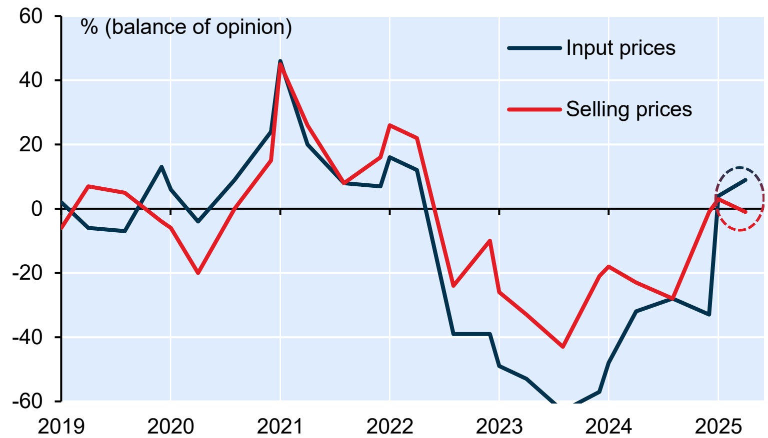
CPI inflation vs share of firms experiencing difficulty meeting demand



Source: NBC, BoC | Note: CPI is Y/Y% change at quarter-end (Q2:2025 = June CPI)

Chart 6: Slight margin compression may limit pass-through

Balance of opinion on input, selling price growth (change of pace)

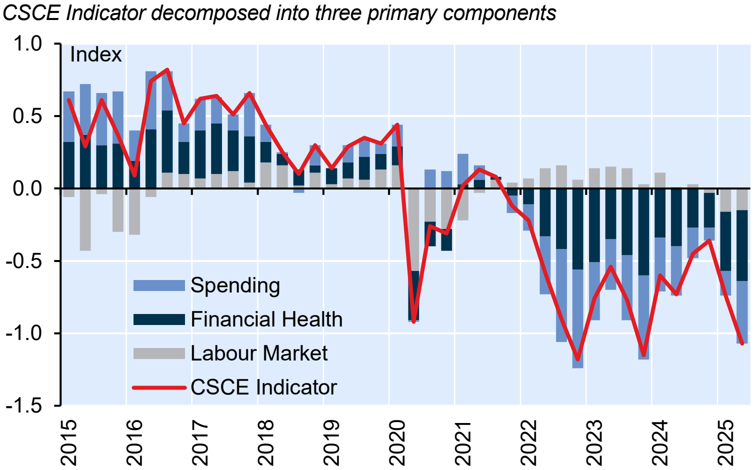


Source: NBC, BoC

There is spare capacity in the Canadian economy as the share of firms unable to meet an unexpected increase in demand is low. Historically, capacity pressures track closely with inflation pressures which leaves us confident inflation will be well contained. While businesses are facing growing input cost pressures, there are indications these won't be fully passed onto the consumer.

Chart 7: Consumer sentiment falls on spending plans

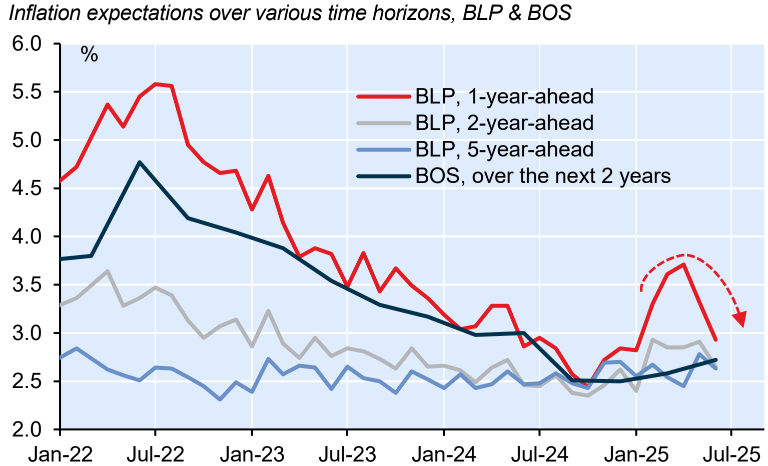
CSCE Indicator decomposed into three primary components



Source: NBC, BoC

Chart 8: Short-run inflation expectations are moderating

Inflation expectations over various time horizons, BLP & BOS



Source: NBC, BoC

It's hard for businesses to pass on higher costs if consumers aren't willing/able to bear them. Indeed, many firms will have to eat tariff costs as consumer spending plans have fallen sharply. This reality may be reflected in near-term inflation expectations which came back to earth. For the BoC, expected price pressures may be a touch high but to us, it's nothing to be overly concerned about.

Table: Perspective on the Business Outlook Survey

Survey indicator with latest / prior readings, interpretation, trend, and question details

		Latest	Prior four surveys						Average		Trend		
	Indicator	2025:Q2	2025:Q1	2024:Q4	2024:Q3	2024:Q2	10 year max	10 year min	2017-19	Intepretation	Recent surveys	vs. prior survey	Survey question / NBF calculation
BOS	Overall BOS Indicator	-2.4	-2.1	-1.1	-2.2	-2.8	5.8	-5.9	1.2	N/A - Summary indicator of BOS		Deteriorating	The BOS indicator is a summary measure of the main Business Outlook Survey questions that gauges overall business sentiment
Sales indicators	Future sales [Balance of opinion]	6	13	31	13	1	52	-35	14.9	Sales expected to accelerate next 12M		Deteriorating	Over the next 12M, the rate of increase in your firm's sales volume (compared with the past 12M) is expected to be…
Sales indicators	Future sales indicators [Balance of opinion]	-6	22	30	11	-1	81	-58	36.7	Future sales indicators worse than 12M ago		Deteriorating	Compared with 12M ago, have your recent indicators (order books, advanced bookings, sales inquiries, etc.)…
Investment indicators	Investment intentions [Balance of opinion]	7	3	32	9	11	47	-30	24.0	More investment spending next 12M than last 12M		Accelerating	Over the next 12M, your firm's investment spending on M&E (compared with the past 12M) is expected to be…
Investment indicators	Credit conditions [Balance of opinion]	16	-3	-3	-7	0	30	-16	-0.9	Credit conditions eased over last 3M		Accelerating	Over the past 3M, how have the terms and conditions for obtaining financing changed (compared with the previous 3M)?
Jobs	Employment level [Balance of opinion]	23	19	33	28	26	77	12	40.9	Employment will be higher 12M from now		Accelerating	Over the next 12M, your firm's level of employment is expected to be…
Capacity pressures	**Some** difficulty meeting demand [Share of firms]	34	28	30	41	34	58	21	37.3	34% would have significant difficulty meeting unexpected demand		More firms with some difficulty	How would you rate the current ability of your firm to meet an unexpected increase in demand?
Capacity pressures	**Significant** difficulty meeting demand [Share of firms]	5	5	9	6	10	30	2	11.2	5% would have some difficulty meeting unexpected demand		More firms with signif. difficulty	How would you rate the current ability of your firm to meet an unexpected increase in demand?
Capacity pressures	**Any** difficulty meeting demand [Share of firms]	39	33	39	47	44	81	27	48.5	39% would have at least some difficulty meeting unexpected demand		More firms with difficulty	NBF calculation - Share of firms that would have some **or** significant difficult meeting an expected increase in demand
Capacity pressures	Labour shortages [Share of firms]	16	20	17	18	15	46	13	28.6	16% of firms experiencing labour shortgages		Fewer firms reporting shortages	Does your firm face any shortages of labour that restrict your ability to meet demand?
Capacity pressures	Labour shortage intensity [Balance of opinion]	-36	-38	-42	-34	-54	74	-54	28.8	Labour shortages less intense than 12M ago		Accelerating	Compared with 12M ago, are labour shortages generally…
Price, wage & inflation expectations	Wage growth [Balance of opinion]	-34	-33	-42	-36	-46	72	-50	17.5	Wages will rise at a slower pace next 12M vs. past 12M		Fewer firms expect faster wage growth	Over the next 12M, are increases in labour costs expected to be higher, lower or about the same rate as over the past 12M?
Price, wage & inflation expectations	Input price growth [Balance of opinion]	9	4	-33	-28	-32	46	-63	11.4	Input prices will rise faster next 12M vs. past 12M		More firms expect faster input price growth	Over the next 12M, are prices of products/services purchased expected to rise at a greater, lesser, or the same rate as past 12M?
Price, wage & inflation expectations	Output price growth [Balance of opinion]	-1	3	-1	-28	-23	45	-43	4.6	Output prices will rise slower next 12M vs. past 12M		Fewer firms expect faster output price growth	Over the next 12M, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past 12M?
Price, wage & inflation expectations	Inflation below 1% next 2 years [Share of firms]	1	0	0	2	0	25	0	1.8	1% of firms expect inflation below 1% over next 2 years		More firms expect sub-1% inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
Price, wage & inflation expectations	Inflation 1-2% next 2 years [Share of firms]	12	23	24	10	3	76	0	53.3	12% of firms expect 1-2% inflation over next 2 years		Fewer firms expect 1-2% inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
Price, wage & inflation expectations	Inflation 2-3% next 2 years [Share of firms]	51	44	51	62	48	62	11	39.0	51% of firms expect 2-3% inflation over next 2 years		More firms expect 2-3% inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
Price, wage & inflation expectations	Inflation above 3% next 2 years [Share of firms]	23	23	20	15	41	84	0	3.5	23% of firms expect inflation above 3% over next 2 years		More firms expect 3%+ inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
Price, wage & inflation expectations	Inflation in target range next 2 years [Share of firms]	72	74	79	81	55.4	100.0	13.3	94.6	72% of responding firms expect inflation between 1-3%		Fewer firms expect inflation in target band	NBF calculation - Share of firms (only those who provided estimate) that expect inflation between 1-3% over the next 2 years.
Price, wage & inflation expectations	Inflation above 2% target next 2 years [Share of firms]	85	74	75	87	96.7	100.0	20.0	43.5	85% of responding firms expect inflation above 2%		More firms expect inflation above 2%	NBF calculation - Share of firms (only those who provided estimate) that expect inflation above BoC's 2% target over next two years.

Source: NBC, BoC

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